No. 12826.

IN THE

United States Court of Appeals

FOR THE NINTH CIRCUIT

LAWRENCE BARKER,

Appellant,

vs.

UNITED STATES OF AMERICA,

Appellee.

Appeal from the United States District Court for the Southern District of California

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REPLY BRIEF FOR APPELLANT.

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TABLE OF AUTHORITIES CITED

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REPLY BRIEF FOR APPELLANT.

(1)

The major portion of appellee's brief (Br. 14-19) is devoted to arguing that this case involves an exchange tax-free under Section 112(b)(3) of the Revenue Act of 1932 (and Sec. 202(c)(2) of the Revenue Act of 1921). Since the lower court refused so to hold, and taxpayer's opening brief was confined to the lower court's position, appellee's argument will be dealt with herein.

Section 112(b)(3) of the Revenue Act of 1932 provides that: "No gain or loss shall be recognized if stock or securities in a corporation a party to a reorganization are, in pursuance of the plan of reorganization, exchanged solely for stock or securities in such corporation or in another corporation a party to the reorganization."

It is important to understand clearly "that a reorganization does not in itself defer any tax. There must be an *exchange* in pursuance of the reorganization." Paul,

Studies in Federal Taxation, 3d Series, p. 45. Section 112(b)(3) requires that the transferor in an exchange must receive *stock or securities in a corporation a party to the reorganization.* "Unless the consideration received was stock or securities in such a corporation, the non-recognition provisions do not apply, even though there is a reorganization." Mertens, *Law of Federal Income Taxation,* Vol. 3, p. 275. This requirement is commonly referred to as the test of "continuity of interest." The transferor must continue to retain a proprietary interest in the business by receipt of stock or securities of the corporation to which the business is transferred. (*Groman v. Commissioner,* 302 U. S. 82 (1937), reh. den. 302 U. S. 654 (1937).)[1]

The courts have uniformly held that where various steps taken, and exchanges made, are parts of a single, common plan, the tax consequences are to be determined by viewing the transaction as a whole, rather than as individual and separate steps. (See, *e. g.: First Seattle Dexter Horton Nat. Bank, et al. v. Commissioner,* 77 F. 2d 45 (C. C. A. 9th, 1935); *Halliburton v. Commissioner,* 78 F. 2d 265 (C. C. A. 9th, 1935); *Schumacher Wall Board Corp.*

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[1]It goes almost without saying, of course, that if none of the transferors retains a proprietary interest in the transferred business, there is not even a reorganization, as defined in Section 112(g) of the Internal Revenue Code (Sec. 112(i) of the Revenue Act of 1932). If, on the other hand, a sufficient number of transferors retains a proprietary interest in the transferred business, there may be a reorganization, and the exchange as to such transferors to the extent of the retained proprietary interest may be tax free under Section 112(b)(3). However, to the extent that certain transferors do not retain a proprietary interest in the transferred business, *i.e.,* do not receive stock or securities in a corporation a party to the reorganization, the exchange by those transferors does not fall within the tax-free provisions of Section 112(b)(3). See *Groman v. Commissioner, supra.*

v. Commissioner, 93 F. 2d 79 (C. C. A. 9th, 1937); *Case v. Commissioner,* 103 F. 2d 283 (C. C. A. 9th, 1939).

In the instant case it is stipulated that the parties agreed to accomplish by the plan to reorganize California the final result that the Lawrence Barker Interests (including taxpayer), in place of their California shares, would own Securities Company (Lawrence Barker, Inc.) shares, whereas Delaware would own all the assets and business of California. [R. 51-56.] The agreement was carried out and the final result accomplished as set forth.

The type of triangular exchange here exemplified by the exchange of California stock for Lawrence Barker, Inc., stock has been considered in numerous cases. All of them hold that where a corporation (California) or its stockholders (Lawrence Barker Interests) end up owning stock in a corporation (Lawrence Barker, Inc.) which owns stock in another corporation (Delaware) which has received the assets, the exchange results in taxable gain or loss. (*Groman v. Commissioner, supra; Helvering v. Bashford,* 302 U. S. 454 (1938); *Hedden, et al. v. Commissioner,* 105 F. 2d 311 (C. C. A. 3d, 1939), cert. den. 308 U. S. 575 (1939), reh. den. 308 U. S. 636 (1939). See also: *Davis v. U. S.,* 26 Fed. Supp. 1007 (Ct. of Cl., 1939), cert. den. 308 U. S. 574 (1939); *Neidich v. Commissioner,* 38 B. T. A. 1178, aff'd *per curiam,* 105 F. 2d 1019 (C. C. A. 3d, 1939), cert. den. 308 U. S. 599 (1939); *Michigan Steel Corporation of New Jersey v. Commissioner,* 38 B. T. A. 435, app. dismissed 116 F. 2d 280 (C. C. A. 6th, 1940); *Lawrence v. Commissioner,* 123 F. 2d 555 (C. C. A. 7th, 1941).) These cases, all following the so-called *Groman-Bashford* doctrine, clearly establish the rule stated above. It can best be understood by referring to the facts of the *Groman* case: Glidden

organized an Ohio corporation, acquiring all its common stock. The shareholders of Indiana, including the taxpayer, transferred all their stock to Ohio in exchange for cash, preferred stock of Ohio, and prior preference stock of Glidden. Indiana was then dissolved and its assets distributed to Ohio. It was agreed that the Ohio preferred stock was stock of a "party to a reorganization" under Section 112(b)(3). As to the prior preference stock of Glidden, it was argued the same result should follow. The Supreme Court, however, held that the tax-free exchange provisions were designed to apply only where the proprietary interest of the stockholders in question continues to be represented *in the corporation to which the assets are transferred.* Glidden prior preference stock represented a proprietary interest in Glidden's assets, not a proprietary interest in Ohio, which had received the Indiana assets. Thus, receipt of Glidden stock could not be tax-free. The Supreme Court said (pp. 89-90):

> "It is argued, however, that Ohio was the *alter ego* of Glidden; that in truth Glidden was the principal and Ohio its agent; that we should look at the realities of the situation, disregard the corporate entity of Ohio, and treat it as Glidden. But to do so would be to ignore the purpose of the reorganization sections of the statute, which, as we have said, is that where, *pursuant to a plan, the interest of the stockholders of a corporation continues to be definitely represented in substantial measure in a new or different one, then to the extent, but only to the extent, of that continuity of interest, the exchange is to be treated as one not giving rise to present gain or loss.* If cash or 'other property'—that is, property other than stock or securities of the reorganized corporations—is received, present gain or loss must be recognized. * * * Was it [Glidden prior preference stock] not 'other

property' in the sense that *qua* that stock *the shareholders of Indiana assumed a relation toward the conveyed assets not measured by a continued substantial inerest in those assets in the ownership of Ohio, but an interest in the assets of Glidden a part of which was the common stock of Ohio?* These questions we think must be answered in the affirmative." (Italics supplied.)

The cases, without exception, hold that where as part of a contemplated plan a corporation, whose assets have been transferred (or its stockholders), receive stock in a corporation *other than the corporation to which the transferred assets are* finally conveyed, the stock received is not acquired tax-free within the provisions of Section 112(b)(3). The net result of the entire transaction controls the tax consequences, even though each step in the plan, if considered separately, would alone constitute a tax-free exchange.

In *Hedden et al. v. Commissioner, supra,* Bethlehem Steel had the right to acquire the assets of the Hedden Company, but directed that they be transferred to Union Company and McClintic-Marshall Company, both wholly owned Bethlehem-subsidiaries, in exchange for which Hedden received Bethlehem bonds and some cash. After reviewing the *Groman* case and refusing to accept the argument that the transfer of the Hedden assets to Bethlehem's nominees was the same as a transfer of those assets to Bethlehem, the Court declared:

"In the instant case after the transfer Union and McClintic had Hedden's assets but the latter no longer had an equivalent continuing interest in the assets, for what it obtained in exchange were not securities in Union and McClintic, but in Bethlehem, a company whose corporate existence was separate and distinct

> from that of its subsidiaries. The fact that Union and McClintic were wholly owned subsidiaries of Bethlehem is, as we have seen, immaterial since they were separate corporations with distinct assets and liabilities whose existence we are not authorized by the Revenue Act to ignore."

In *Anheuser-Busch, Inc., et al. v. Commissioner,* 40 B. T. A. 1100 (1939), aff'd, 115 F. 2d 662 (C. C. A. 8th, 1940), cert. den. 312 U. S. 699 (1941), Anheuser-Busch, which owned all the stock of Melrose (New York), on August 26, 1930, entered into an agreement with Borden under the terms of which the properties of Melrose (New York) were to be transferred to Borden in exchange for the issuance to Anheuser-Busch of 35,000 shares of Borden stock. In September 1930, Borden organized a Delaware corporation (Delaware) and agreed to turn over to Delaware, in consideration for the issuance of all Delaware's stock, the properties of Melrose (New York) which Borden was to acquire. The above agreements were carried out, and on September 26, 1930, the Melrose (New York) properties were conveyed to Borden in exchange for the issuance to Anheuser-Busch of 35,000 Borden shares. On the same day, Borden conveyed those properties to Delaware, in exchange for all of Delaware's stock. It was found as a fact that Anheuser-Busch was in no way consulted as to the desirability or advisability of the organization of Delaware by Borden to take over the Melrose (New York) properties; and that Anheuser-Busch had no direct interest in the disposition of the Melrose (New York) assets by Borden after such assets had been transferred to Borden.

It was argued that the tax consequences should be determined by considering each step in the above transactions separately; that the stock of Borden received by the tax-

payer was received in a tax-free exchange in connection with a reorganization, since such had been issued in exchange for substantially all the properties of Melrose (New York) which had been transferred directly to Borden; that the second step in the transaction, whereby Borden conveyed those properties to Delaware, its wholly-owned subsidiary, considered as a separate transaction, was also a tax-free exchange under Section 112(b)(5), and should not be deemed to destroy the non-recognization of gain on the transaction since the agreement embodying the plan did not specifically require the organization of or transfer to Delaware, but made it wholly optional with Borden. The Board, although conceding that the transaction would have constituted a tax-free exchange if each step in the transaction were considered separately, held that since it was a contemplated possibility, under the plan which actually eventuated, that the property received by Borden would be transferred to its wholly-owned subsidiary, the tax consequences of the various steps were to be determined by viewing the transaction as a whole. Since at the completion of the transaction Anheuser-Busch owned stock in Borden, it no longer had a continuing proprietary interest in the Melrose (New York) properties which were owned by Delaware and thus the exchange of its Melrose stock for Borden stock was not a tax-free exchange. Said the Board (pp. 1106-1107):

> "In each of these cases the transfer was actually made to a subsidiary nominee of the parent. There was no provision of the plan which required the participation of the subsidiary. In each case it was the privilege of the parent, the party to the contract of reorganization, to determine whether it or its subsidiary would receive the transferred property. In

each case we may assume that, if the parent itself had elected to receive and hold the property, the rule of the *Groman* and *Bashford* cases would have been inapplicable. In each case, however, the parent chose to avail itself of the optional provision and to have the property conveyed to its subsidiary. The transferor in those cases was not entitled to be consulted, and for all that appears was not. *The conclusion to be gathered from these decisions is therefore that the intervention of a subsidiary will be treated as a part of the plan, if it is a contemplated possibility under the plan and actually eventuates.*

*   *   *   *   *   *   *   *

"It is true petitioner had no voice in the decision that the property was to be received and held by Delaware rather than by Borden. Neither did those contracting on behalf of the transferors in the *Mellon* and *Hedden* cases. It may also be true that through the exercise of volition by a third person petitioner and Melrose were placed in the position of having entered into a taxable transaction in lieu of one that would have been tax-free. But that is no more than to say that by their own act they put it within the power of another so to control the essential character of that transaction that the taxing provisions of the revenue act became operative. That is no justification for concluding that they did not become operative, nor for relieving petitioner and Melrose of the tax consequences of the transaction which actually eventuated. To hold otherwise would be tantamount to applying the tax law on the basis of what was hoped for rather than what occurred." (Italics supplied.)

See, also: *Edith G. Goldwasser v. Commissisoner,* 47 B. T. A. 445 (1942), aff'd *per curiam* 142 F. 2d 556 (C. C. A. 2d, 1944), cert. den. 323 U. S. 765 (1944).

Another group of cases is different with respect to the type of transfers involved, but identical in net result with the cases previously discussed herein. These cases involve a situation where pursuant to a plan, the business property of a corporation is conveyed to "A" corporation, in exchange for the issuance, to the transferring corporation or its stockholders, of stock in "A" corporation, which stock the recipient then exchanges for stock in "B" corporation. The net result of such transfers is, of course, identical with that of the cases previously discussed herein, namely, that the transferor ends up owning stock in "B" corporation, while the transferred properties come to rest in "A" corporation. Again, despite the variation in the form of transaction, the courts, *considering only the ultimate result thereof,* have consistently applied the *Groman* rule and held that since the transferor ends up owning stock in a corporation other than the corporation which ultimately receives the transferred business property, the stock received by the transferor does not represent a continuing proprietary interest in the transferred assets, and may therefore not be received tax free.

In *United Light & Power Co. v. Commissioner,* 38 B. T. A. 477, aff'd 105 F. 2d 866 (C. C. A. 7th, 1939), cert. den. 308 U. S. 574 (1939), several similar sets of transactions were entered into, one of which comprised the transfer by United Light & Railways Company (Railways) of part of its property to the Dexter Company, a new corporation, in exchange for all the stock of Dexter. Railways then transferred all the Dexter stock to the American Light & Traction Company (American) in exchange for stock of that company.

The taxpayer argued that the transfer by Railways to Dexter in exchange for all Dexter's stock, was a separate

complete transaction, which constituted a tax-free exchange, a transfer of part of the assets of a corporation in exchange for control of the transferee. It further contended that the transfer by Railways of all the Dexter stock to American in exchange for American stock, was another separate, complete transaction, which also constituted a tax-free exchange pursuant to a reorganization, *i. e.,* the acquisition by one corporation (American) of at least a majority of the stock of another corporation (Dexter) in return for a consideration representing a continuity of interest (stock of American). The Board recognized that if the tax consequences of the two exchanges were to be determined by considering each exchange separately, the taxpayer would prevail. It was held, however, by both the Board and the Circuit Court of Appeals, that the tax consequences could not be so determined, rather, as contended by the Government, "the two transfers * * * were three-way exchanges, pursuant to a single plan." Viewing the transaction as a whole, therefore, since the net result was that the consideration finally acquired by Railways in place of its original property was stock of American, while the transferred property itself was owned by Dexter, it was held that the transaction did not constitute a tax-free exchange.

The same result was reached in *Commissioner v. First National Bank v. Altoona, et al.,* 104 F. 2d 865 (C. C. A. 3d, 1939), cert. dismissed 309 U. S. 691 (1940), and *Whitney Corp., et al. v. Commissioner,* 38 B. T. A. 224 (1938), aff'd 105 F. 2d 438 (C. C. A. 8th, 1939), where again each of two transfers, if considered independently, would have resulted in a tax-free exchange.

Because the determination of the status of a particular exchange as tax-free or taxable also controls the question of the basis for gain or loss to be used by the taxpayer

upon a subsequent disposition of his newly acquired stock, Randolph E. Paul, eminent authority on tax law, predicted in 1940 that Government victories in the *Groman* type of case "may be boomerangs" where the question involved is, as in the instant case, the taxpayer's basis for gain or loss. *Paul, Studies in Federal Taxation,* Third Series (1940), p. 121. The accuracy of Mr. Paul's prophesy has been amply demonstrated.

In *Illinois Water Service Co. v. Commissioner,* 2 T. C. 1200 (1943) (Acq. 1944 C. B., p. 15), Foshay Co., after becoming the sole stockholder of the Freeport Water Co., in 1936, caused the Freeport properties to be transferred to another corporation, Peoples Illinois, in exchange for which Foshay received all the stock of Peoples Illinois. Instead of retaining the Peoples Illinois stock, however, Foshay transferred it to its controlled corporation, Peoples, in exchange for Peoples stock. The Commissioner contended that the transfer of the Freeport properties to Peoples Illinois constituted a tax-free exchange and that the basis of the Freeport properties in the hands of Peoples Illinois was thus the same basis as such properties had in the hands of Freeport. The Court held, however, that Peoples Illinois did not receive the Freeport property pursuant to a tax-free exchange (p. 1234), and that the basis to Peoples Illinois of the Freeport property was the fair market value on November 15, 1926, of its stock which it had issued for such property. Although Foshay had originally acquired the stock of the corporation (Peoples Illinois) to which the Freeport property had been transferred, the temporary ownership of that stock by Foshay was too transitory to supply the required continuity of interest in the Freeport property. By immediately exchanging the Peoples Illinois stock for stock of Peoples, Foshay destroyed the requisite continuity of inter-

est, since it then held stock in a corporation (Peoples) other than the corporation in which the Freeport properties ultimately vested (Peoples Illinois).

See, also: *Rotenberg v. Sheehan, et al.*, 48 Fed. Supp. 584 (E. D. Mo. 1943), Govt's app. dismissed, C. C. A. 8th, September 11, 1944.

Appellee admits, as it must, that there can be no tax-free exchange within Section 112(b)(3) where a stockholder receives "stock in some corporation other than the corporation to which the transferred assets were ultimately conveyed." (Br. 17.) Nor can appellee deny, in view of the uncontradicted state of the record, that the plan adopted in 1923 for the reorganization of California provided that at the completion thereof the Lawrence Barker Interests, in place of their California stock, would own stock in Lawrence Barker, Inc., that Delaware would own the business and assets of California, and that the Lawrence Barker Interests would own no stock in Delaware, and that such was the actual result of the plan as consummated. [R. 51-56.] Appellee's argument herein is clear. Its position is that the exchange by the California stockholders (including taxpayer) of their California stock for Delaware was one tax-free exchange under Section 112(b)(3) of the Revenue Act of 1932 and Section 202(c)(2) of the Revenue Act of 1921; and that the exchange by the Lawrence Barker Interests of their Delaware stock for Lawrence Barker, Inc., stock was another tax-free exchange under Section 112(b)(5) of the Revenue Act of 1932 and Section 202(c)(3) of the Revenue Act of 1921. The fundamental fallacy in appellee's argument, of course, is its attempt to determine the tax consequences of the 1923 exchanges by considering the tax consequences of each step separately. This is precisely

the reasoning which every court, without exception, has rejected.

See, *e. g.*: *United Light & Power Co. v. Commissioner, supra; Anheuser-Busch, Inc., et al. v. Commissioner, supra,* and other cases cited herein.

Appellee admits that here the reorganization "plan was full and complete [R. 51-56]." (Br. 16.) It neglects to point out, however, that the formation of Lawrence Barker, Inc., was not only "a contemplated possibility under the plan [which] actually eventuate[d]." (See *Anheuser-Busch, Inc., et al. v. Commisioner, supra.*) but *in fact the entire set of agreements and the plan,* all of which were entered into by the C. H. Barker Interests, the Lawrence Barker Interests, and Bankers, *specifically provided that Lawrence Barker, Inc., would be formed, that it would receive the Delaware stock, and that the Lawrence Barker Interests would receive only Lawrence Barker, Inc., stock in place of the California stock which they had originally owned.* [R. 51-56.] Moreover, to state, as does appellee, that "the creation of Lawrence Barker, Inc., served only the individual purposes of the * * * Lawrence Barker Interests" and that its function "could as well have been performed whether it had been incorporated or not" (Br. 18-19), is not only to ignore the stipulated facts, but even if true would be completely immaterial. (See, *Anheuser-Busch, Inc., et al., v. Commissioner, supra.*)

The appellee pays lip service to the uncontrovertible legal proposition that Lawrence Barker, Inc., cannot be treated as "the *alter ego* of the Lawrence Barker Interests" (Br. 18) and that it cannot "ignore [the] corporate entity" of Lawrence Barker, Inc. (Br. 18.) In the same breath, however, it declares that to sustain the tax-

payer's position here "would * * * ignore the intra-identity of Lawrence Barker, Inc., and the individuals comprising the Lawrence Barker Interests" (Br. 17); thus "recognition of Lawrence Barker, Inc., as the effective owner of stock in Delaware perverts the substance of the 1923 transactions * * *". (Br. 21.)

Appellee recognizes that it can "not contend in this respect that Lawrence Barker, Inc., was a party to the reorganization." (Br. 16.) It asserts that "such a contention is not necessary to the application of Section 112(b)(3)." (Br. 16.) But since the corporate existence of Lawrence Barker, Inc., cannot be ignored, and since it must be acknowledged that its formation was a part of the plan agreed to by all of the interested parties for the reorganization of California, and since in accordance with that plan its stock was the stock finally received by taxpayer in exchange for his California stock, it necessarily follows that because Lawrence Barker, Inc., is not "a party to the reorganization," the receipt of its stock in place of California stock cannot be a tax-free exchange under Section 112(b)(3).

Although in its brief below appellee stated "The defendant makes no contention that the stockholders of Lawrence Barker, Inc., as such, acquired any direct proprietary interest in the assets and business of the California corporation" which were transferred to Delaware, it here asserts that there is "clear continuity * * * of interest" (Br. 17), presumably because Lawrence Barker, Inc.'s "only function is to hold securities." (Br. 18.) Apart from the fact that Lawrence Barker, Inc., has remained in existence for more than 25 years, paying taxes upon its income, and its shareholders doing likewise with respect to dividends received therefrom, appellee's statement is refuted by every case cited herein.

In its attempt to distinguish the *Groman* line of cases, appellee asserts "Where a stockholder holds stock in the parent of a wholly-owned subsidiary, his control of the subsidiary is admittedly indirect and elusive, and it may be convincingly argued that there is no continuity of interest between the individual and the subsidiary." (Br. 17.) In short, appellee concedes that if Lawrence Barker, Inc., had been the parent of Delaware, its wholly-owned subsidiary, there would be no continuity of interest between the stockholders of Lawrence Barker, Inc., and Delaware; but since in the instant case Lawrence Barker, Inc., owned only a *portion* of Delaware's stock, appellee concludes that the stockholders of Lawrence Barker, Inc., therefore had a direct continuity of interest in Delaware. Appellee's attempt thus to distinguish the *Groman* line of cases simply highlights the fact that as a result of those cases the present case *a fortiori* involves a taxable exchange. Obviously, if the receipt by the transferor of property, of stock in a parent corporation whose wholly-owned subsidiary has received the transferor's property, does not give the transferor a continuing proprietary interest in the transferred property, certainly the receipt by the transferor of stock in a corporation (Lawrence Barker, Inc.) which merely owns *some* stock in the corporation (Delaware) which has received the transferred property, cannot afford the transferor a continuing proprietary interest in the transferred property.

Nevertheless, appellee urges that the doctrine enunciated in the *Groman* case and related cases, should not be applied to the instant case. It declares simply that to apply the principle established by those cases (a principle established at the Government's behest, incidentally) "is to take too superficial a view of what really happened in

1923 and 1924 herein." (Br. 18.) Appellee is, however, unable to cite a single case in affirmative support of its position. Its inability, of course, stems from the fact that in every recorded case after the *Groman* decision the courts have held that a stockholder engages in a tax-~~free~~ ABLE exchange where as part of a plan his corporation transfers its assets to another corporation and the stockholder receives stock in a corporation other than the corporation to which the transferred assets are conveyed. It is because of the foregoing that appellee sees fit to admit that to hold taxpayer herein engaged in a tax-free exchange would present "an apparent conflict with the * * * *Groman* and *Bashford* line of decisions." (Br. 21.)

(2)

The lower court determined the tax consequences of the 1923 exchange whereby the Lawrence Barker Interests transferred their California stock and received in its place stock of Lawrence Barker, Inc., by attempting to assess the tax consequences of the two exchanges separately. It concluded that the first transaction whereby all the common stockholders of California exchanged their stock for Delaware stock was a tax-free exchange within Section 112(b)(5). If such conclusion were correct (and taxpayer has shown in its opening brief why he feels it was not, since the transferors were not in "control" of Delaware after the exchange), the basis to the taxpayer of his California stock would, of course, be carried over to the Delaware stock issued for the California stock. If the second transfer by the Lawrence Barker Interests of the Delaware stock to Lawrence Barker, Inc., in exchange for Lawrence Barker, Inc., stock were considered a separate transaction which was never contemplated as part of the original plan, the basis of the Lawrence Barker, Inc.,

stock in the hands of the taxpayer would be the same as the Delaware stock. Taxpayer has never contended to the contrary. (Br. 20, 32.) Since the lower court chose to predicate its decision upon the ground that the first exchange in 1923 should be treated as a separate transaction whereby all the California stockholders exchanged their California stock for Delaware stock and that such exchange qualified as a 112(b)(5) exchange, taxpayer in his opening brief felt it only necessary to point out that such conclusion is erroneous, because of the pre-existing obligation on the part of the Lawrence Barker Interests, pursuant to the plan, to transfer more than 20% of the Delaware stock to Bankers. Obviously, if the exchange by all the California stockholders of their California stock for Delaware stock, was not a tax-free exchange, it is uncontroverted that the basis of the Delaware stock in the hands of Lawrence Barker Interests (including taxpayer) would be the cost of that stock, *i. e.*, the fair market value of $4,387,000 of the California stock given in exchange therefor. Since this is true, the fact that the exchange by the Lawrence Barker Interests of their Delaware stock for Lawrence Barker, Inc., stock, if considered as a separate transaction which was never contemplated as part of the original plan, might, as appellee urges (Br. 12-13, 19-20), qualify under Section 112(b)-(5), is wholly immaterial. Even so, the Lawrence Barker, Inc., stock in the hands of the Lawrence Barker Interests would also take a basis of $4,387,000. Thus the lower court is in error not only in treating the 1923 exchanges as separate independent transactions not originally contemplated under the plan as adopted, but even if it were proper so to determine the tax consequences, the court still erred in holding that after the first exchange by all the common stockholders of California for Dela-

ware stock, such transferors were in "control" of Delaware within the meaning of Section 112(b)(5).

Appellee endeavors to support the lower court's conclusion that the transfer by all the California stockholders of their stock for Delaware stock, considered as a separate transaction, was a tax-free exchange under Section 112-(b)(5) by asserting that the obligation of the Lawrence Barker Interests to transfer $2,087,000 (20,870) shares of the Delaware stock to Bankers was not a part of the plan originally agreed to by the Lawrence Barker Interests, the C. H. Barker Interests and Bankers; that it was an obligation "independent of and foreign to" such plan, in "no way connected" therewith, and "must be considered a part of another transaction." (Br. 23, 21-22.) We prefer to stand on the record. The stipulated facts show that the original agreement between the Lawrence Barker Interests and the C. H. Barker Interests specifically provided for the participation of Bankers (in precisely the fashion that Bankers did in fact participate), *i. e.,* that Bankers would acquire $1,087,000 of Delaware stock, would have an option to buy another 1,000,000 of such stock and would also buy the remaining $413,000 of Delaware First Preferred stock from Delaware in order to provide funds to retire the outstanding preferred stock of California. [R. 45, 51-56.] At the same time Bankers entered into binding agreement with the C. H. Barker Interests and the Lawrence Barker Interests to perform those functions [R. 57-64], which agreement it fulfilled in every detail. Clearly without the participation of Bankers the plan could never have been adopted or consummated. But perhaps the best answer to this argument by appellee is to quote from its own brief (Br. 5):

> "This agreement adopted a plan of reorganization. [R. 51-56.] * * * *It* [the plan] *also*

contemplated the sale to Marshall Field, Glore, Ward & Company (hereinafter referred to as Bankers) of certain stock in Barker Delaware, and the granting of an option to Bankers to purchase further Barker Delaware stock. [R. 55-56.]" (Italics supplied.)

Appellee also argues that "there was an obligation to sell only 10,870 shares to Bankers" (Br. 23); that the option granted to Bankers to purchase an additional 10,-000 shares was "nothing more than a continuing offer to sell," and that until accepted, no contract existed. (Br. 23.) But it is fundamental law that "if consideration is paid for an offer, the offer is a contract. Such contracts are generally called options." (*Williston on Contracts,* Vol. I, Sec. 61, p. 106 (1926 Ed.).) "The word 'option' is often used for any continuing offer regardless of whether it is revocable for lack of consideration; but more commonly the word is used to denote an offer that is irrevocable and therefore a contract." (*Restatement of the Law of Contracts,* Sec. 24, p. 301.) Here, as part of the original plan, Bankers bound themselves to purchase 10,870 shares of Delaware stock; also to purchase another $413,000 of Delaware stock in order to provide Delaware with the funds to redeem the outstanding preferred stock of California. In consideration of those promises Bankers were given an option, which it exercised, to purchase the remaining $10,000 shares of Delaware stock. [R. 24, 45-56.] To argue that the Lawrence Barker Interests were not obligated to sell to Bankers the additional 10,000 shares of Delaware is to ignore completely both the stipulated facts and basic principles of contract law. The point is well exemplified in *National Rubber Machinery Company v. United States,* discussed on pages 28 and 29 of taxpayer's opening brief.

Commissioner v. First National Bank of Altoona, et al., 104 Fed. Sec. 865 (C. C. A. 3rd, 1939), cited by appellee (Br. 23), was in no way concerned with Section 112(b)-(5). The existence of an option therein (which apparently was never exercised) was entirely immaterial to the issues presented. In fact, the case involved only the question of the application of the *Groman* doctrine. Since the transferor in that case did not end up owning stock in corporation to which the assets had been transferred, the decision of the Board of Tax Appeals holding there was a tax-free exchange, was reversed by the Circuit Court on the authority of the intervening decision in the *Groman* case.

Respectfully submitted,

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May, 1951.